Michigan Department of Treasury
496 (02/06)

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended.

Local Unit of Government Type	Local Unit Name	County
☐County ☐City ☐Twp ☐Village ☒Other	Hurley Medical Center	Genesee

Fiscal Year End	Opinion Date	Date Audit Report Submitted to State
6/30/06	9/22/06	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

	YES	NO	**Check each applicable box below.** (See instructions for further detail.)
1.	☒	☐	All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2.	☒	☐	There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3.	☒	☐	The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4.	☒	☐	The local unit has adopted a budget for all required funds.
5.	☒	☐	A public hearing on the budget was held in accordance with State statute.
6.	☒	☐	The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7.	☒	☐	The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8.	☒	☐	The local unit only holds deposits/investments that comply with statutory requirements.
9.	☒	☐	The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan,* as revised (see Appendix H of Bulletin).
10.	☒	☐	There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11.	☒	☐	The local unit is free of repeated comments from previous years.
12.	☒	☐	The audit opinion is UNQUALIFIED.
13.	☒	☐	The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14.	☒	☐	The board or council approves all invoices prior to payment as required by charter or statute.
15.	☒	☐	To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)
Financial Statements	☒	
The letter of Comments and Recommendations	☒	
Other (Describe)	☐	

Certified Public Accountant (Firm Name)	Telephone Number		
Plante & Moran, PLLC	810-767-5350		
Street Address	**City**	**State**	**Zip**
111 E. Court Street, Suite 1a	Flint	MI	48502

Authorizing CPA Signature	Printed Name	License Number
Tadd Harburn	Tadd Harburn, CPA	1101014134

Hurley Medical Center
Flint, Michigan

Financial Statements

with Additional Information

June 30, 2006 and 2005

Hurley Medical Center

Contents

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Independent Auditor's Report

To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

We have audited the accompanying financial statements of the business-type activities of Hurley Medical Center (a component unit of the City of Flint, Michigan) as of June 30, 2006 and 2005, which collectively comprise the Medical Center's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of Hurley Medical Center as of June 30, 2006 and 2005 and the results of its operations, changes in its fund net assets, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements do not present a management's discussion and analysis, which would be an analysis of the financial performance for the year. The Governmental Accounting Standards Board has determined that this analysis is necessary to supplement, although not required to be a part of, the basic financial statements.

Plante & Moran, PLLC

September 22, 2006

Hurley Medical Center

Balance Sheets

Assets	June 30, 2006 Primary Government Hurley Medical Center	June 30, 2006 Component Unit Hurley Health Services	June 30, 2005 (as restated) Primary Government Hurley Medical Center	June 30, 2005 (as restated) Component Unit Hurley Health Services
Current assets:				
Cash and cash equivalents	$ 20,112,540	$ 2,553,368	$ 21,463,737	$ 2,453,682
Patient accounts receivable, net (Note 4)	58,975,912	315,601	66,327,636	326,661
Other receivables	7,659,076	785,302	7,726,612	566,568
Inventories	3,290,619	53,214	3,545,637	40,081
Prepaid expenses and other	2,348,436	1,289,148	2,247,145	1,341,537
Assets limited as to use (Note 5)	3,510,414	334,158	4,319,753	326,912
Total current assets	95,896,997	5,330,791	105,630,520	5,055,441
Assets limited as to use (Note 5):				
By the board	59,754,231	334,158	49,911,728	326,912
Under bond indenture agreement - Held by trustee	12,457,972	-	12,363,497	-
Restricted	390,113	-	369,340	-
Total assets limited as to use	72,602,316	334,158	62,644,565	326,912
Less assets limited as to use that are required for current liabilities	(3,510,414)	(334,158)	(4,319,753)	(326,912)
Total noncurrent assets whose use is limited	69,091,902	-	58,324,812	-
Other assets:				
Defeasance loss, net	894,053	-	1,022,042	-
Bond issuance costs, net	630,927	-	700,810	-
Software license, net	-	-	-	-
Investment in joint ventures (Note 14)	6,296,628	1,153,809	5,366,269	1,579,367
Other	-	150,000	-	59,430
Total other assets	7,821,608	1,303,809	7,089,121	1,638,797
Capital assets, net (Note 17)	60,762,071	1,348,831	59,271,985	1,557,032
	$ 233,572,578	**$ 7,983,431**	**$ 230,316,438**	**$ 8,251,270**

See notes to financial statements.

Liabilities and Fund Net Assets	June 30, 2006 Primary Government Hurley Medical Center	June 30, 2006 Component Unit Hurley Health Services	June 30, 2005 (as restated) Primary Government Hurley Medical Center	June 30, 2005 (as restated) Component Unit Hurley Health Services
Current liabilities:				
Accounts payable and taxes withheld	$ 15,430,844	$ 206,119	$ 14,663,217	$ 135,371
Current portion of long-term debt and lease obligations (Notes 6 and 7)	3,797,912	-	3,630,789	-
Accrued expenses	32,582,586	1,256,749	20,737,316	1,279,723
Total current liabilities	51,811,342	1,462,868	39,031,322	1,415,094
Accrued expenses (Note 13)	40,952,281	-	33,945,547	-
Lease obligations, net of current portion (Note 7)	1,379,634	-	2,979,013	-
Long-term debt, net of current portion (Note 6)	64,277,937	-	66,258,673	-
Total liabilities	158,421,194	1,462,868	142,214,555	1,415,094
Fund net assets:				
Invested in capital assets, net of related debt	6,954,524	1,348,831	1,837,183	1,557,032
Unrestricted	64,673,823	5,171,732	83,135,040	5,279,144
Restricted	3,523,037	-	3,129,660	-
Total fund net assets	75,151,384	6,520,563	88,101,883	6,836,176
	$ 233,572,578	**$ 7,983,431**	**$ 230,316,438**	**$ 8,251,270**

Hurley Medical Center

Statements of Revenues, Expenses, and Changes in Fund Net Assets

	Year Ended June 30			
	2006		2005 (as restated)	
	Primary Government	Component Unit	Primary Government	Component Unit
	Hurley Medical Center	Hurley Health Services	Hurley Medical Center	Hurley Health Services
Operating revenues:				
Net patient service revenues	$ 268,543,435	$ 4,335,585	$ 277,628,457	$ 4,315,995
Other operating revenues	27,644,161	18,004,860	24,216,879	17,055,893
Total operating revenues	296,187,596	22,340,445	301,845,336	21,371,888
Operating expenses:				
Salaries and wages	126,524,408	14,002,158	126,072,402	13,881,578
Professional services	32,298,913	84,854	30,523,309	81,259
Payroll taxes and fringes	50,196,050	2,712,468	46,699,433	2,610,760
Supplies	37,738,735	-	35,501,721	-
Purchased services and other	48,027,466	5,374,785	50,994,472	5,016,146
Depreciation and amortization expense	10,347,386	223,991	10,227,045	256,523
Total operating expenses	305,132,958	22,398,256	300,018,382	21,846,266
Net operating income (loss)	(8,945,362)	(57,811)	1,826,954	(474,378)
Nonoperating revenues (expenses):				
Interest expense	(4,503,057)	-	(2,957,176)	-
Investment income and unrestricted donations	121,581	58,367	2,302,979	259,414
Management fees to PHO and joint venture income (expense)	(247,034)	(316,169)	(718,499)	(114,335)
Total nonoperating expenses	(4,628,510)	(257,802)	(1,372,696)	145,079
Excess (deficiency) of revenues over expenses before other activity	(13,573,872)	(315,613)	454,258	(329,299)
Other:				
Assets released from restrictions for the purchase of capital assets	229,996	-	317,329	-
Excess (deficiency) of revenues over expenses before captial contributed, restricted fund activity, and transfer of funds	(13,343,876)	(315,613)	771,587	(329,299)
Capital contributed, restricted fund activity, and transfer of funds:				
Restricted gifts and bequests	1,798,029	-	1,647,519	-
Income and investments	81,684	-	45,205	-
Transfer of funds to general fund:				
Capital asset additions	(229,996)	-	(317,329)	-
Other operating revenue (expenses)	(1,256,340)	-	(1,352,260)	-
Increase (decrease) in fund net assets	(12,950,499)	(315,613)	794,722	(329,299)
Fund net assets - Beginning of year, as restated (Note 16)	88,101,883	6,836,176	87,307,161	7,165,475
Fund net assets - End of year	**$ 75,151,384**	**$ 6,520,563**	**$ 88,101,883**	**$ 6,836,176**

See notes to financial statements.

Hurley Medical Center

Statements of Cash Flows

	Year Ended June 30			
	2006		2005 (as restated)	
	Primary Government	Component Unit	Primary Government	Component Unit
	Hurley Medical Center	Hurley Health Services	Hurley Medical Center	Hurley Health Services
Cash flows from operating activities:				
Receipts from patients and insurance companies	$ 327,965,134	$ 22,132,771	$ 324,448,625	$ 21,494,571
Payments to vendors	(171,953,465)	(8,428,802)	(194,621,084)	(8,016,250)
Payments to employees	(126,524,408)	(14,002,158)	(126,072,402)	(13,881,578)
Net cash provided by (used in) operating activities	29,487,261	(298,189)	3,755,139	(403,257)
Cash flows from investing activities:				
Distributions from joint ventures	2,100,000	-	1,808,126	-
Purchases of assets whose use is limited	(70,836,722)	(7,246)	(56,948,926)	(326,912)
Sale of assets whose use is limited	59,422,478	-	58,122,216	-
Purchase of stock certificates	-	(1,500)	-	-
Sale of stock certificates	-	-	-	1,500
Payments on notes receivable	-	304,613	-	30,000
Interest on investments	203,265	126,575	2,348,184	43,524
Net cash provided by (used in) investing activities	(9,110,979)	422,442	5,329,600	(251,888)
Cash flows from noncapital financing activities:				
Net proceeds from contributions restricted for specific purposes	1,798,029	-	1,647,519	-
Joint venture income	(3,277,393)	-	(3,396,442)	-
Net cash used in noncapital financing activities	(1,479,364)	-	(1,748,923)	-
Cash flows from from capital and related financing activities:				
Repayment of long-term debt and capital leases	(3,627,256)	-	(3,413,948)	-
Interest paid on long-term debt	(4,373,849)	-	(4,690,886)	-
Proceeds from interest rate swap	-	-	1,568,119	-
Purchase of capital assets	(12,924,080)	(31,747)	(9,408,570)	(71,105)
Proceeds from sale of assets	677,070	7,180	62,863	31,833
Net cash provided by (used in) financing activities	(20,248,115)	(24,567)	(15,882,422)	(39,272)
Net increase (decrease) in cash and cash equivalents	(1,351,197)	99,686	(8,546,606)	(694,417)
Cash and cash equivalents at beginning of year	21,463,737	2,453,682	30,010,343	3,148,099
Cash and cash equivalents at end of year	**$ 20,112,540**	**$ 2,553,368**	**$ 21,463,737**	**$ 2,453,682**

See notes to financial statements.

(continued)

Statements of Cash Flows (continued)

	Year Ended June 30			
	2006		2005 (as restated)	
	Primary Government	Component Unit	Primary Government	Component Unit
	Hurley Medical Center	Hurley Health Services	Hurley Medical Center	Hurley Health Services
Reconciliation of operating income (loss) to net cash from operating activities:				
Operating income (loss)	$ (8,945,362)	$ (57,811)	$ 1,826,954	$ (474,378)
Adjustments to reconcile operating income (loss) to net cash from operating activities:				
Depreciation and amortization	10,347,386	223,991	10,227,045	256,523
Provision for bad debt	25,783,919	-	34,970,385	-
Amortization of bond discounts, issuance costs, and other deferred charges	100,372	-	278,553	-
Amortization of deferred defeasance gain	342,253	-	216,734	-
(Gain) loss on disposal of assets	2,004,843	-	(787,267)	-
Provision for income taxes	-	(60,606)	-	(58,341)
Contribution released from restrictions	(1,256,340)	-	(1,352,260)	-
Changes in operating assets and liabilities:				
Patient and other accounts receivable	(18,364,659)	(207,674)	(45,867,185)	122,683
Inventories	255,018	(13,133)	(323,189)	(40,081)
Prepaid expenses and other	(101,291)	(230,729)	6,734	(102,204)
Interest receivable on assets whose use is limited	(169,301)	-	(118,036)	-
Accounts payable and taxes withheld	767,627	70,748	(47,908)	(229,791)
Accrued expenses	18,722,796	(22,975)	4,724,579	122,332
Net cash provided by (used in) operating activities	**$ 29,487,261**	**$ (298,189)**	**$ 3,755,139**	**$ (403,257)**

Noncash transactions:

The Medical Center recorded an increase in the investment from current operations in joint ventures in the amount of $3,030,359 and $2,677,943 for 2006 and 2005, respectively.

The Medical Center acquired capital assets with the issuance of capital lease obligations in the amount of $35,625 in 2005.

During 2005, Hurley Practice Management Services sold its investment in a joint venture with the issuance of a note receivable in the amount of $415,500.

See notes to financial statements.

Note 1 - Nature of Business and Significant Accounting Policies

Organization and Reporting Entity - Hurley Medical Center (the "Medical Center") is a component unit of the City of Flint, Michigan. The Medical Center provides inpatient, outpatient, and emergency care services in Genesee and surrounding counties. As an instrumentality of a political subdivision of the State of Michigan, as described in Section 115 of the Internal Revenue Code, the Medical Center is exempt from Federal income taxes.

The City of Flint Hospital Building Authority (the "Authority") is a blended component unit of the Medical Center and the City of Flint. The Authority only serves the Medical Center by facilitating the issuance of debt for certain capital improvements and equipment via a lease contract. In accordance with generally accepted accounting principles, the lease transactions between the Medical Center's and the Authority have been eliminated and all debt and related assets have been recorded in the Medical Center's financial statements.

Hurley Health Services (HHS), a municipal support organization, is a wholly owned subsidiary of the Medical Center and is reported as a component unit. HHS, on a consolidated basis, is comprised of two nonprofit entities (HHS and The Hurley Clinics (THC)) and one "for profit" corporation (Hurley Practice Management Services, HPMS).

Proprietary Fund Accounting - The Medical Center utilizes the proprietary fund method of accounting whereby, revenues and expenses are recognized on the accrual basis. The proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict Governmental Accounting Standards board (GASB) pronouncements, in which case GASB prevails.

Basis of Presentation - The Medical Center follows GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments,* in the presentation of its financial statements. Under GASB 34, the Medical Center is classified as a special purpose government and is required to present statements required for Enterprise Funds.

Cash and Cash Equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less, excluding amounts whose use is limited by board designation or other arrangements under trust agreements or with third-party payors.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Assets Limited as to Use - Assets limited as to use include:

- Assets set aside by the board of managers for identified purposes, over which the board retains control, and may at its discretion subsequently use for other purposes.
- Proceeds of debt issues and funds of the Medical Center deposited with a trustee and limited to use in accordance with the requirements of a bond indenture.
- Assets restricted by outside donors.

Investments and Investment Income - The Medical Center accounts for its investments in accordance with GASB No. 31, *Accounting for Certain Investments and for External Investment Pools*. All investments are valued at their fair values in the balance sheet except money market investments and interest earning investment contracts that have a remaining maturity of less than one year at the time of purchase. These investments are carried at amortized cost. Unrealized gains and losses are included in the statement of operations as nonoperating revenues - investment income.

Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, and investment income on assets deposited in the self-insurance trust are reported as operating revenues - other revenue. Investment income from all other General Fund investments and investment income of endowment funds are reported as nonoperating revenue. Investment income and gains (losses) on investments of donor-restricted funds are added to (deducted from) the appropriate restricted fund balance.

The investments in joint ventures are recorded on the equity method of accounting.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Accounts Receivable - Accounts receivable for patients, insurance companies and governmental agencies are based on gross charges. An allowance for uncollectible accounts is established on an aggregate basis by using historical loss rate factors applied to unpaid accounts based on aging. Loss rate factors are based on historical loss experience and adjusted for economic conditions and other trends affecting the Medical Center's ability to collect outstanding amounts. Uncollectible amounts are written off against the allowance for uncollectible accounts in the period they are deemed to be uncollectible. The allowance for contractual adjustments and interim payment advances is based on expected payment rates from payors based on current reimbursement methodologies. This amount also includes amounts received as interim payments against unpaid claims by certain payors.

Inventories - Inventories are stated at the lower of cost (first-in, first-out) or market.

Bond Issuance Cost - Costs related to the issuance of bonds are deferred and amortized over the life of the bonds. Costs amortized during periods of construction are added to the cost of the related projects.

Deferred Defeasance Loss - The defeasance loss associated with defeased debt is capitalized and amortized over the life of the new debt.

Capital Assets - Capital assets are stated at cost and depreciated over the estimated useful lives of the related assets. Prior to 1997, the Medical Center utilized an accelerated method of depreciation for substantially all assets. In 1997, the Medical Center switched to straight-line depreciation for all new acquisitions.

Compensated Absences - The Medical Center's employees earn vacation days at varying rates depending on years of service and job classification. Employees may accumulate vacation days up to a specified maximum. The Medical Center's policy is to accrue such unpaid vacation days as they are earned. The estimated amount of vacation days payable is reported as a current liability in both 2006 and 2005.

Employees of the Medical Center generally are eligible for receiving a portion of unused sick leave benefits only upon retirement, death, or duty-related disability. The Medical Center's policy is to recognize these sick leave benefits at the time an employee becomes vested for retirement or duty-related disability, or in the case of death. The estimated amount of sick leave payable for employee meeting these requirements is reported as a noncurrent liability in both 2006 and 2005.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Certain employee groups, however, are eligible to receive a portion of unused sick leave benefits on an annual basis. The Medical Center's policy is to accrue such unpaid sick leave benefits as they are earned. The estimated amount of sick leave payable for employees eligible to receive a portion of unused sick leave benefits on an annual basis is reported as a current liability in both 2006 and 2005.

Classification of Fund Net Assets - Fund net assets of the Medical Center are classified in three components. Fund net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to the Medical Center. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

Net Patient Service Revenue - Net patient service revenue is reported at the estimated net realizable amounts from patients and third-party payors for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Approximately 74 percent and 75 percent of the Medical Center's revenues are based on participation in the Blue Cross/Blue Shield, Medicare, and Medicaid programs for the years 2006 and 2005, respectively.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Management believes that it is in compliance with all applicable laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

Operating Revenues and Expenses - The Medical Center's statement of revenues, expenses, and changes in fund net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services - the Medical Center's principal activity. Nonexchange revenues, including grants and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services, other than financing costs.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Restricted Resources - When the Medical Center has both restricted and unrestricted resources available to finance a particular program, it is the Medical Center's policy to use restricted resources before unrestricted resources.

Estimated Self-insured Malpractice Costs - The provision for estimated self-insured medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The estimate for claims incurred but not reported is based on an actuarial determination.

Interest Expense - Interest expense is charged to operations as incurred, except that interest on funds borrowed for major construction projects, which is capitalized as a component of the cost of the related projects during the period that the borrowed funds are owed.

Income Taxes - The Medical Center and HHS are exempt from income taxes except for HHS's subsidiary, Hurley Practice Management Services. A provision for income taxes (at statutory rates) has been provided for in the financial statements related to this entity's transactions.

Nonoperating Revenues and Expenses - The Medical Center categorizes joint ventures, investment income, and operations that the Medical Center does not directly oversee as nonoperating activities.

Charity Care - The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge. Because the Medical Center does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. During 2005, the Medical Center changed the method in which it applies its charity care policy. The eligibility criteria are now based on levels of income. The affect of the full year of the change in 2006 was to decrease revenue recognized of approximately $10 million with a corresponding decrease in bad debt expense as compared to 2005.

Estimates - The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Note 1 - Nature of Business and Significant Accounting Policies (Continued)

Reclassifications - Certain amounts in the 2005 financial statements have been reclassified to correspond to the current year classifications.

Note 2 - Charity Care

The Medical Center maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy, the estimated cost of those services and supplies, and equivalent service statistics. The following information measures the level of charity care provided during the years ended June 30, 2006 and 2005.

	2006	2005
Charges foregone, based on established rates	$ 11,346,296	$ 1,119,193
Estimated costs and expenses incurred to provide charity care	$ 4,764,528	$ 550,529
Equivalent percentage of charity care patients to all patients served	1.56%	0.16%

Note 3 - Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments to the Medical Center at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Most outpatient services are paid on an ambulatory payment classification system or fee schedule methodology. Inpatient nonacute services and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology subject to certain limitations.

Medicaid - Inpatient acute care services rendered to Medicaid program beneficiaries are paid at prospectively determined rates per discharge. Outpatient services rendered to Medicaid program beneficiaries are reimbursed based on a fee schedule methodology. Capital costs are paid on a cost reimbursement method.

Note 3 - Net Patient Service Revenue (Continued)

Blue Cross/Blue Shield - Inpatient, acute care services are reimbursed at prospectively determined rates per discharge. These rates are based on the Medicare patient classification system and on hospital specific costs. Outpatient services are reimbursed on a fee for service basis.

HMO/PPO - Services rendered to HMO and PPO beneficiaries are paid at predetermined rates or as a percentage of hospital charges.

Cost report settlements result from the adjustment of interim payments to final reimbursement under the Medicare, Medicaid, and Blue Cross/Blue Shield of Michigan programs and are subject to audit by fiscal intermediaries. The 2005 net patient service revenue decreased approximately $710,000 due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations. During 2006, there was no impact to net patient service revenue due to settlement activity.

Note 4 - Patient Accounts Receivable

Patient accounts receivable at June 30, 2006 and 2005 and revenues for the years then ended include estimated amounts due from various third-party payors which are computed in accordance with their respective reimbursement formulas.

In addition, the Medical Center has established an estimated allowance for uncollectible accounts of approximately $15,650,000 and $26,100,000 at June 30, 2006 and 2005, respectively.

The Medical Center grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of gross receivables from patients and third-party payors at June 30, 2006 and 2005 was as follows:

	Percent	
	2006	2005
Medicare	12	11
Medicaid	17	18
Blue Cross/Blue Shield of Michigan	13	17
Other third-party payors and patients	58	54
Total	100	100

Note 5 - Assets Limited as to Use

Assets limited as to use that are required for obligations classified as current liabilities are reported in current assets. Assets limited as to use at June 30, 2006 and 2005 consisted of the following:

	2006	2005
By board for funded depreciation and capital improvements:		
Cash and cash equivalents	$ 3,238,098	$ 9,073,321
U.S. government securities (cost was $41,189,675 and $31,466,708 for 2006 and 2005, respectively)	39,474,435	31,337,550
Accrued interest receivable	148,090	82,791
Total	42,860,623	40,493,662
By board for self-insurance:		
Cash and cash equivalents	1,549,762	369,423
U.S. government securities (cost was $10,992,969 and $3,314,555 for 2006 and 2005, respectively)	10,777,813	3,352,941
Mutual funds (cost was $4,044,831 and $4,821,171 for 2006 and 2005, respectively)	4,439,510	5,660,738
Accrued interest receivable	126,523	34,964
Total	16,893,608	9,418,066
Total board-designated	$ 59,754,231	$ 49,911,728

Note 5 - Assets Limited as to Use (Continued)

	2006	2005
Under bond indenture agreement - Held by trustee:		
Cash and cash equivalents	$ 9,421,870	$ 9,325,417
U.S. government securities (cost was $2,852,626 and $2,870,798 for 2006 and 2005, respectively)	2,926,430	2,944,675
Accrued interest receivable	109,672	93,405
Total	$ 12,457,972	$ 12,363,497
Restricted - Cash and cash equivalents	$ 390,113	$ 369,340

HHS assets limited as to use include a certificate of deposit used to secure the letter of credit disclosed in Note 6.

Note 6 - Lease Purchase Commitments and Long-term Debt

Lease purchase commitments and long-term debt are as follows as of June 30, 2006 and 2005:

	2006	2005
Lease purchase contract, revenue refunding bonds, Series 1995A, with annual payments ranging from $2,275,000 in 2000 to $1,130,000 in 2007, plus interest at 5.25 percent to 7.00 percent through 2007	$ 1,130,000	$ 2,200,000
Lease purchase contract, revenue refunding bonds, Series 1998A, with annual payments ranging from $485,000 in 2000 to $1,315,000 in 2021, plus interest at 4 percent to 5.375 percent through 2021	14,090,000	14,705,000
Lease purchase contract, revenue refunding bonds, Series 1998B, with annual payments ranging from $335,000 in 2000 to $1,320,000 in 2029, plus interest at 4 percent to 5.375 percent through 2029	18,105,000	18,510,000

Note 6 - Lease Purchase Commitments and Long-term Debt (Continued)

	2006	2005
Lease purchase contract, revenue refunding bonds, Series 2003, with annual payments ranging from $1,680,000 in 2008 to $3,550,000 in 2021, plus interest at 6.00 percent to 6.50 percent through 2021	$ 35,000,000	$ 35,000,000
Total	68,325,000	70,415,000
Less unamortized bond discount	1,852,063	2,066,327
Net	66,472,937	68,348,673
Less current portion	2,195,000	2,090,000
Net long-term debt	$ 64,277,937	$ 66,258,673

The following is a reconciliation of the future principal and interest payments to the recorded liability at June 30, 2006:

2007	$ 5,933,394
2008	6,385,244
2009	6,383,869
2010	6,361,219
2011	6,353,225
After 2011	71,149,898
	102,566,849
Less amount representing interest	34,241,849
Total lease purchase commitments and long-term debt	$ 68,325,000

The revenue refunding bonds are payable from the revenues of the Medical Center pursuant to lease/purchase agreements between the Medical Center and the City of Flint Building Authority. Under terms of the lease/purchase agreements, the Medical Center has transferred title to substantially all of its facilities to the Authority and leases such facilities from the Authority. Ownership of the facilities reverts to the Medical Center upon payment of the bonds. Rental payments to the Authority are equal to the amounts required to make principal and interest payments on the bonds.

Note 6 - Lease Purchase Commitments and Long-term Debt (Continued)

The net revenues of the Medical Center are pledged for payment of principal and interest on the variable rate demand revenue rental and revenue refunding bonds. Accordingly, the financial statements of the Medical Center include the facilities as if owned by the Medical Center and the bonds as if issued by the Medical Center.

The lease purchase agreements contain certain restrictive covenants. At June 30, 2006, the Medical Center was not in compliance with certain of these covenants, including minimum debt service requirements, and has received either a waiver or notification from the trustee that the trustee will not be taking any of the remedial actions permitted by the indenture.

During 2005, the Medical Center entered into an interest rate swap agreement with a swap provider. At June 30, 2006, the notional principal amount of the Medical Center's portion of the outstanding interest rate swap agreement was $35 million. The agreement effectively changes the Medical Center's interest rate exposure on $35 million of fixed percent bonds due July 1, 2008 and July 1, 2020 to a variable rate. The interest rate swap agreement matures on July 1, 2011. Unrealized losses on the swap agreement of $1,905,149 and $1,568,199 at June 30, 2006 and 2005, respectively, have not been recorded in accordance with governmental accounting standards.

HHS has an unused irrevocable letter of credit of $326,000 as of June 30, 2006 and 2005 that is collateralized by a certificate of deposit.

Note 7 - Lease Obligations

The Medical Center has a capital lease agreement for equipment and software expiring in 2007 and 2008. The equipment and software have been capitalized and the related obligation recorded using the interest rate implicit in the lease. The assets are being depreciated over their useful lives. The amount of assets under the capital leases was $539,606 at June 30, 2006 and 2005 and the related accumulated depreciation was $370,600 and $257,929 at June 30, 2006 and 2005, respectively.

The Medical Center also has two sale-leaseback agreements with a bank for equipment expiring in 2008 and 2009. The equipment has been capitalized and the related obligation recorded using the interest rate implicit in the lease. The assets are being depreciated over their useful lives. The sale-leaseback agreements contain restrictive covenants containing minimum cash flow, minimum total and pledged liquid assets, minimum unrestricted net assets, and maximum liabilities to net asset ratio requirements. Although certain of these covenants were not met at June 30, 2006, the Medical Center has received a waiver of the violation from the bank.

Note 7 - Lease Obligations (Continued)

The following is a reconciliation of the future minimum lease payments to the recorded liability at June 30, 2006:

2007	$ 1,709,866
2008	1,338,937
2009	75,539
Total future minimum payments	3,124,342
Less amount representing interest	141,796
Total obligation under capital leases	2,982,546
Less current portion	1,602,912
Long-term obligation under capital leases	$ 1,379,634

Note 8 - Retirement Plans

The most recent actuarial valuation providing the disclosures in accordance with Statement No. 25 and 27 is as of June 30, 2004. Significant details regarding the Medical Center's retirement plans are presented below:

Description of Plans

The Medical Center contributes to the City of Flint Employees Retirement System, which is a single-employer public employee retirement system (PERS). It is the responsibility of the City of Flint PERS to function as an investment and administrative agent for the Medical Center with respect to the pension plans. The City of Flint PERS is administered by a board of trustees. Investments of the City of Flint PERS are made through JP Morgan Chase Trust Department and the Northern Trust Company.

The Medical Center has three plan options covering substantially all employees of the Medical Center. The basic plan option, which is the Old Contributory Pension Plan (OCPP), provides for employer contributions, as well as requiring employee contributions based upon a percent of pay. Benefits fully vest after 15 years of service or at age 55 with 10 years of service. Under OCPP, employees may retire any time after completion of 25 years of credited service or at age 55 with 10 years of credited service. The lifetime monthly retirement benefit under OCPP is the participant's final average compensation (which is the average of the highest 5 out of the last 10 years of credited service) times 2 percent of the first 25 years of credited service and 1 percent for every year thereafter.

Note 8 - Retirement Plans (Continued)

A second plan option is the Modified Contributory Pension Plan (MCPP) which provides for employer contributions, as well as requiring employee contributions, based upon a percent of pay, but at rates higher than those required under OCPP. Benefits fully vest after 15 years of service or at age 55 with 10 years of service. Employees may retire any time after completion of 25 years of credited service or at age 55 with 10 years of credited service. The lifetime monthly retirement benefit under MCPP is the participant's final average compensation (which is the average of the highest three out of the last five years of credited service) times 2 percent of the first 15 years of credited service, plus 2.2 percent of the next 10 years of credited service, and 1 percent of every year of credited service beyond year 25.

A third plan option is the Hurley Alternative Pension Plan (HAPP) which provides for only an employer contribution and no employee contribution. Benefits fully vest after 10 years of credited service and a normal retirement age of 60. There are provisions for early retirement at age 55 with a reduced benefit (based upon actuarial assumptions to reflect the additional years of benefit payments). The lifetime monthly retirement benefit under HAPP is the participant's final average compensation (which is the average of the highest 5 out of the last 10 years of credited service) times 1.5 percent for all years of credited service.

Benefit provisions are authorized by contract.

Nonexempt employees (members of bargaining units) may participate in either MCPP or HAPP. Exempt employees may participate in only one of any of the three plans (MCPP, HAPP, or OCPP).

The PERS issues a separate financial report which can be obtained from the pension and payroll department at City Hall - City of Flint, Michigan.

Funding Policy - Employee contributions

	Exempt	Nonexempt
OCPP	3.75% of first $4,200 of compensation and 5.75% on compensation over $4,200	Not eligible
MCPP	4.5% of first $4,200 of compensation plus 6.5% of compensation over $4,200	7% of pay
HAPP	None	None

Note 8 - Retirement Plans (Continued)

The Medical Center makes employer contributions in accordance with funding requirements determined by an independent actuary. If a member leaves service, he or she may withdraw his or her employee contributions together with interest.

Actuarial Assumptions

The information presented in the required supplementary schedules was determined as a part of the actuarial valuation made at June 30, 2004.

Valuation date	June 30, 2004
Actuarial cost method	Individual Entry Age
Amortization method	Level percent
Remaining amortization period	30 years
Asset valuation method	4-year smoothed market
Actuarial assumption:	
Investment rate of return	7.75%
Projected salary increases	3.95%-7.55%
Includes wages inflation at	3.75%
Cost of living adjustments	None

Annual Pension Cost

Three-year trend information regarding the annual pension cost (APC), percentage of APC contributed, and net pension obligation (NPO) are summarized as follows:

Fiscal Year End	Actuarial Valuation Date	Annual Pension Cost (APC)	% of APC Contributed	Net Pension Obligation at June 30	Annual Required Contribution (ARC) Rate as a % of Covered Payroll
6/30/2004	12/31/2002	$ -	100.0%	$ -	0.00%
6/30/2005	12/31/2002	8,967,695	100.0%	-	8.39%
6/30/2006	6/30/2004	8,965,839	13.1%	7,790,552	8.00%

Note 8 - Retirement Plans (Continued)

During the fiscal year ended June 30, 2004, seven of nine employee unions plus the exempt employees voted to change participation from the City of Flint PERS to the Michigan Municipal Public Employees Retirement System (MERS). As of June 30, 2006, no transfers of pension funds have been made from the City of Flint PERS to MERS. A contribution of $1,175,287 was made to the MERS plan by the Medical Center during 2006. Contributions to the City of Flint PERS and MERS for the remaining 2006 net pension obligation will be made to city of Flint PERS and MERS pending an actuarial study on how much to fund each plan. The annual contribution rate for MERS payroll used by the Medical Center in 2006 was 8.6 percent.

Defined Contribution Plan

The Medical Center has a defined contribution plan for employees who meet certain requirements as to date of hire. Contributions to the plan are 4.5 percent of the employee's annual compensation. Each employee's interest is vested as specified in the plan. Pension expense included in the statement of revenues, expenses, and changes in fund net assets was $644,566 and $551,267 for the years ended June 30, 2006 and 2005, respectively.

Profit-sharing and 403(b) Retirement Plan

HHS has a qualified 401(k) profit-sharing plan for HPMS employees. Eligible employees, those that have attained the age of 21 and completed 90 days of service, may defer up to 15 percent of their salary. HHS may make a discretionary contribution. HHS contributions to the 401(k) plan were $45,919 and $35,262 for 2006 and 2005, respectively. HHS also maintains two tax-deferred annuity plans under section 403(b) of the Internal Revenue Code. Under the plans, HHS and THC employees may elect to defer up to a percentage of their salary, subject to the Internal Revenue Service limits. HHS may make a discretionary contribution. HHS's contributions to the 403(b) plans amounted to $335,680 and $331,346 for 2006 and 2005, respectively.

Note 9 - Leases

Hurley Medical Center and Hurley Health Services lease office space under various operating leases. Certain operating leases contain rental escalation clauses that are based on prime rate at a future date and purchase options at fair market value. The following is a schedule, by year, of future minimum rental payments required under noncancellable operating leases as of June 30, 2006:

	Hurley Medical Center	Hurley Health Services
2007	$1,655,336	$830,010
2008	1,439,142	802,629
2009	1,280,243	663,106
2010	989,416	599,430
2011	596,385	599,430
2012 and after	1,013,533	1,832,757
Total minimum payments required	$6,974,055	$5,327,362

Rental expense for all operating leases for Hurley Medical Center for the years ended June 30, 2006 and 2005 amounted to $1,644,130 and $1,631,256, respectively. Rental expense for all operating leases for Hurley Health Services for the years ended June 30, 2006 and 2005 amounted to $989,969 and $1,095,791, respectively, including rental paid to Hurley Medical Center of $456,528 and $465,395 for the years ended June 30, 2006 and 2005, respectively.

Note 10 - Contingencies and Commitments

Contingencies

Malpractice claims have been asserted against the Medical Center by various claimants. The claims are in various stages of assertion, including some that have been brought to trial. Counsel is unable to conclude about the ultimate outcome of the actions; however, it is probable that certain actions will result in unfavorable settlements for the Medical Center. There also are known incidents, which occurred through June 30, 2006, that may result in the assertion of additional claims. Management is of the opinion that the settlement of those claims probable of unfavorable outcome, as well as the settlement, if any, of such other asserted and unasserted claims, are within the amount of liability accrued for unpaid claims, as disclosed in Note 13. Consequently, management believes that such settlements will not significantly affect the Medical Center's financial results. The Medical Center maintains an irrevocable trust to be used for the payment of settlements. The Medical Center funds the trust based upon an annual actuarial determination. The Medical Center purchased a stop-loss insurance policy relating to malpractice claims, which will limit the future claims that will be paid from the irrevocable trust.

There are various legal actions pending against HHS, its subsidiaries, and certain employees. Due to the inconclusive nature of these actions, it is not possible for legal counsel of HHS to determine in the aggregate either the probable outcome of these actions or a reasonable estimate of HHS's ultimate liability, if any. HHS maintains what it believes to be adequate coverage of malpractice, errors and omissions, and directors and officers insurances to cover any possible claims.

Commitments

As of June 30, 2006, HPMS is contingently liable as guarantor with respect to 50 percent of $5,447,660 of indebtedness of Hurley/Binson's Medical Equipment, Inc. Hurley Practice Management Services owns 50 percent of Hurley/Binson's Medical Equipment, Inc. The book value of the investment is $1,140,309 and $1,546,479 at June 30, 2006 and 2005, respectively. No material loss is anticipated by reason of such guarantee. There are no recourse rights in the event of default by Hurley/Binson's Medical Equipment, Inc.

The future minimum payments related to the above debt are: 2007 - $4,226,717; 2008 - $468,132; 2009 - $234,762; 2010 - $127,400; and 2011 - $390,649.

Subsequent to year end, in September 2006, Hurley/Binson's Medical Equipment, Inc. obtained additional funds from the bank increasing the mortgage note on its building to $1,260,000. This is an increase of debt to the bank of approximately $620,000, of which HPMS guarantees 50 percent.

Note 11 - Postretirement Health Care Benefits

Effective for retirements on or after July 1, 1983, Hurley Medical Center provides a portion of health insurance premiums for retired employees. The insurance premium for retired employees ranges from $156 to $1,787 per month to age 65 and a Medicare supplement after age 65. Retired exempt employees receive full or partial coverage, depending on date of employment at no cost to the retiree. Retired non-exempt employees pay the full amount or a portion of the premium. No payment is made if the retired employee is covered under other employment. The estimated cost of such benefits is accrued based on a level percent of payroll. Accrued costs charged to expense were $5,942,485 and $3,099,680 in the years ended June 30, 2006 and 2005, respectively. The number of participants eligible to receive benefits was 667 and 642 in the years ended June 30, 2006 and 2005, respectively. The Medical Center maintains a trust to be used for payment of its portion of health insurance premiums for retired employees.

Note 12 - Other

Prior to 1993, the Medical Center was classified under the jurisdiction of the Financial Accounting Standards Board (FASB) and the financial statements and related disclosures were in compliance with FASB requirements. In January 1993, the Accounting Standards Board issued Statements of Auditing Standard No. 69 *The Meaning of "Present Fairly in Conformity with Generally Accepted Accounting Principles (GAAP)*." This statement revised the GAAP hierarchy which is the auditor's uniform standard for judging the fairness of the overall presentation of the financial statements. As a result of the issuance of SAS 69, all governmental entities and component units thereof are to be classified under the jurisdiction of the Governmental Accounting Standard Board (GASB).

The Medical Center's disclosures 1-11 remained similar to the prior year to maintain the comparability of the Medical Center to the health care industry. The following are the additional disclosures required by the GASB:

Deposits

The Medical Center's deposits consist of checking and savings accounts and money market funds. At year end, the carrying amount of the Medical Center's deposits was $16,610,840 (excluding petty cash of $11,405), and the bank balance was $18,953,266. Of the bank balance, $500,000 was covered by federal depository insurance. The bank balance includes $14,209,729 of money market funds that are collateralized by securities not in the name of the Medical Center. The rest of the bank balance, or $4,243,537, was not insured or collateralized.

Note 12 - Other (Continued)

HHS's deposits consist of checking accounts and money market funds. Deposits are recorded on the financial statements as cash and cash equivalents. At year end, the carrying amount of HHS's deposits (excluding petty cash) was $2,551,710 and the bank balance was $2,906,061. The bank balance was higher than the carrying value due to outstanding checks that had not yet cleared the bank at June 30, 2006. Of the bank balance, $200,003 was covered by federal depository insurance.

Investments

Michigan Compiled Laws Section 129.91 (Public Act 20 of 1943, as amended) authorizes local governmental units to make deposits and invest in the accounts of federally insured banks, credit unions, and savings and loan associations that have offices in Michigan. The local unit is allowed to invest in bonds, securities, and other direct obligations of the United States or any agency or instrumentality of the United States; repurchase agreements; bankers' acceptances of United States banks; commercial paper rated within the two highest classifications, which matures not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions, which are rated as investment grade; and mutual funds composed of investment vehicles that are legal for direct investment by local units of government in Michigan.

The retiree health care fund is also authorized by Michigan Public Act 314 of 1965, as amended, to invest in certain reverse repurchase agreements, stocks, diversified investment companies, annuity investment contracts, real estate leased to public entities, mortgages, real estate (if the trust fund's assets exceed $250 million), debt or equity of certain small business, certain state and local government obligations and certain other specified investment vehicles.

The Medical Center currently has designated four financial institutions for the deposit of its funds. The investment policy adopted by the board in accordance with Public Act 196 of 1997 has authorized investment in all of the items listed above. The Medical Center's deposits and investment policies are in accordance with statutory authority.

Note 12 - Other (Continued)

The Medical Center's cash and investments are subject to several types of risk, which are examined in more detail below:

Custodial Credit Risk of Investments - Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Medical Center will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Medical Center has a policy for custodial credit risk that requires the safekeeping agent to undergo an annual evaluation of creditworthiness by the chief investment officer through the review of its annual financial statements and/or the use of credit rating agencies. The safekeeping agent is a member of the Securities Investor Protection Corporation (SIPC). Securities held in the safekeeping account are insured up to $500,000 and cash is insured to $100,000 through this program.

The balance of the investments is not insured and is not registered with securities held by the counterparty or by its trust department or agent but not in the Medical Center's name. The investments subject to custodial credit risk at June 30, 2006 and 2005 are as follows:

	Fair Value		
Investment Type	2006	2005	
U.S. government or agency bonds	$ 15,704,180	$ 8,318,349	Counterparty's trust department
U.S. government or agency bonds	11,693,700	9,993,950	Counterparty's trust department
Commercial paper	1,129,822	1,000,716	Counterparty's trust department
Repurchase agreement	18,090,137	18,306,862	Counterparty's trust department
	$ 46,617,839	$37,619,877	

Note 12 - Other (Continued)

Interest Rate Risk - Interest rate risk is the risk that the value of investments will decrease as a result of a rise in interest rates. As a means of limiting its exposure to fair value losses arising from rising interest rates, the Medical Center's investment policy indicates that no investment shall have, at the time of purchase, an average life of more than five years. Investments other than mortgage-backed securities may not have a maturity of more than 10 years. As of June 30, 2006 and 2005, the Medical Center had the following investments and maturities.

		2006 Investment Maturities		
Investment Type	Fair Value	Less than One Year	One to Five Years	Six to Ten Years
U.S. government or agency bonds	$27,470,311	$ 5,300,318	$12,296,174	$9,873,819
U.S. government CMOs	24,535,546	452,329	24,083,217	-
Commercial paper	1,129,822	1,129,822	-	-
Repurchase agreement	18,090,137	18,090,137	-	-
	$ 71,225,816	$24,972,606	$36,379,391	$9,873,819
	100.00%	35.06%	51.08%	13.86%

		2005 Investment Maturities		
Investment Type	Fair Value	Less than One Year	One to Five Years	Six to Ten Years
U.S. government or agency bonds	$18,402,973	$6,413,065	$6,255,228	$5,734,679
U.S. government CMOs	18,154,135	19,334	18,134,801	-
Commercial paper	1,000,716	1,000,716	-	-
Repurchase agreement	18,306,862	18,306,862	-	-
	$ 55,864,686	$25,739,977	$24,390,029	$5,734,679
	100.00%	46.07%	43.66%	10.27%

Note 12 - Other (Continued)

Credit Risk - As of June 30, 2006 and 2005, the credit quality ratings of debt securities that are not explicitly guaranteed by the U.S. government are as follows:

	Fair Value			
	2006	2005	Rating	Rating Organization
U.S. government or agency bonds	$20,884,986	$14,368,846	AAA	Standard & Poors
U.S. government CMOs	24,535,546	18,154,135	Not rated	
Commercial paper	1,129,822	1,000,716	A1+	Standard & Poors
Repurchase agreement	18,090,137	18,306,862	Not rated	
	$64,640,491	$51,830,559		

Concentration of Credit Risk - The Medical Center's investment policy limits any single investment to 10 percent of the portfolio, with the exception of cash or U.S. Treasuries, and further restricts the combined mortgage-backed securities may not exceed 50 percent of the portfolio. No single investment exceeded 5 percent of the investment portfolio at June 30, 2006.

Long-term debt - Changes in the Medical Center's long-term debt (which is detailed in Note 6) and lease obligations (which are detailed in Note 9) is as follows:

	2006		2005	
	Long-term Debt (Including Current Portion)	Lease Obligations (Including Current Portion)	Long-term Debt (Including Current Portion)	Lease Obligations (Including Current Portion)
Liability at beginning of year	$68,348,673	$4,519,804	$70,106,939	$5,923,125
Additions:				
New lease obligations	-	-	-	35,625
Amortization of bond discount	214,264	-	216,734	
Reductions - Payments	(2,090,000)	(1,537,258)	(1,975,000)	(1,438,946)
Liability at end of year	$66,472,937	$2,982,546	$68,348,673	$4,519,804

Note 13 - Risk Management

The Medical Center is exposed to various risks of loss, including hospital professional and patient general liability claims. The Medical Center has established a trust to assist in accumulating resources to fund excess insurance premiums and to pay claims.

The Medical Center's self-insured retention is $6 million for the first annual occurrence and $4 million for each additional occurrence annually with excess claims-made coverage up to $15 million annually. Claims in excess of $15 million are to be covered by the Medical Center. The Medical Center employs the use of an actuary to provide an analysis of the existing claims and to estimate the liability for incurred but not reported (IBNR) claims.

The carrying amount of liabilities for unpaid claims amounted to $32,996,608 and $25,242,445 at June 30, 2006 and 2005, respectively.

The following represents the change in the aggregate liabilities for claims and defense costs payable for the years ended June 30, 2006 and 2005:

	Claims and Defense Costs Payable	
	2006	2005
Balance - Beginning of year	$25,242,445	$21,545,354
Claims paid	(2,938,750)	(8,619,433)
Defense costs and other fund expenses	(1,461,412)	(2,155,973)
Excess insurance premium payments	(1,652,230)	(1,821,833)
Increase in claims liability	13,806,555	15,294,330
Balance - End of year	$32,996,608	$25,242,445
Insurance trust assets (at market) - End of year	$12,510,868	$3,603,534

Note 14 - Joint Ventures

Hurley Medical Center participates in six privately held joint ventures, Greater Flint Area Hospital Imaging Center, Inc., (GFAHIC), Flint Health Systems Imaging Center, Inc., (FHSIC), HGH, Inc., (HealthPlus Partners), Hurley PHO of Mid-Michigan, Michigan Lithotripsy Network, and Genesys Hurley Cancer Institute. Each corporate joint venture is recorded in the financial statements in accordance with Accounting Principles Board Statement 18 on the equity method of accounting.

Note 14 - Joint Ventures (Continued)

GFAHIC and FHSIC provide magnetic resonance imaging (MRI) services to the greater Flint and Genesee County community. The ownership of both corporations is allocated between Hurley Medical Center, Genesys Regional Medical Center, and McLaren Regional Medical Center. The joint venture provides that each participant shares in the annual earnings/loss of the corporations. The net investment by the Medical Center at June 30, 2006 and 2005 was $3,471,309 and $3,713,657, respectively. A total of $1,600,000 and $1,800,000 was distributed to the Medical Center during the year ended June 30, 2006 and 2005, respectively.

HGH, Inc., is a joint venture among Hurley Medical Center, HealthPlus of Michigan, Inc., Genesys Regional Medical Center, and Memorial Health Care Center. The venture was established during 1995 to provide a methodology to enroll Medicaid patients in the statewide managed care initiative for Medicaid. The Medical Center has a negative net investment (obligation) of $(258,060) and $(702,570) at June 30, 2006 and 2005, respectively. The arrangement provides that the three entities will share in the income or losses of the joint venture. This joint venture was dissolved as of December 31, 2005.

Hurley PHO of Mid-Michigan is a joint venture between Hurley Medical Center and its medical staff. The venture was established during 1997 to provide vertically integrated continuous care which will facilitate the Medical Center participating in managed care contracts in the future. The Medical Center's net investment at June 30, 2006 and 2005 was $493,156 and $395,991, respectively. The arrangement provides that the Medical Center will be allocated 50 percent in income or losses of the joint venture.

Michigan Lithotripsy Network is a joint venture between Hurley Medical Center and six other hospitals. The venture was established during 1999 to provide a mobile lithotripsy unit to be utilized by the participating hospitals. The arrangement provides that the seven hospitals will share equally in the income or losses of the joint venture. The Medical Center's net investment at June 30, 2006 and 2005 was $0 and $31,061, respectively. The Michigan Lithotripsy Network was sold in 2006 for $500,000, resulting in a net gain to the Medical Center of $468,939.

Genesys Hurley Cancer Institute is a joint venture between Hurley Medical Center and Genesys Regional Medical Center. The venture was established during 2001, to provide outpatient oncology services, including laboratory, and radiation oncology. The Medical Center's net investment at June 30, 2006 and 2005 was $2,590,223 and $1,928,130, respectively. The arrangement provides that the two entities will share equally in the income or losses of the joint venture.

Note 14 - Joint Ventures (Continued)

HPMS has a 50 percent ownership in Hurley/Binson's Medical Equipment, Inc. The Medical Center's net investment at June 30, 2006 and 2005 was $1,140,309 and $1,456,479, respectively. Investment loss recognized in the years ended June 30, 2006 and 2005 using the equity method was $316,169 and $178,310, respectively.

Note 15 - Related Party Transactions

The Medical Center provides services to one of its joint ventures, HGH, Inc. As of June 30, 2006 and 2005, the net settlement receivable from HGH, Inc. was $3,390,139 and $8,033,365, respectively and is included in patient accounts receivable on the balance sheet. The net patient revenue recorded from HGH, Inc. was $14,402,873 and $19,757,125 for the years ended June 30, 2006 and 2005, respectively.

The Medical Center pays subsidies and management fees for services rendered to HHS. Management fees and contributions from the Medical Center to HHS for the years ended June 30, 2006 and 2005 amounted to $16,565,607 and $15,751,845, respectively, of which $13,268,126 and $12,355,403, respectively, is staff and service contracts and $3,297,481 and $3,396,442, respectively, is network management fees. Amounts paid by HHS to the Medical Center for rent and other miscellaneous expenses for the years ended June 30, 2006 and 2005 amounted to $820,228 and $841,687, respectively.

As of June 30, 2006 and 2005, the Medical Center had accounts receivable from HHS of $58,529 and $63,794, respectively, and accounts payable to HHS of $561,301 and $325,194, respectively.

Included in other operating revenues of HHS are management fees and marketing fees for services rendered paid by Hurley/Binson's Medical Equipment, Inc., a related party to HPMS. Management fee and marketing income from Hurley/Binson's Medical Equipment, Inc. for the years ended June 30, 2006 and 2005 amounted to $84,000 and $122,968, respectively. There were accounts receivable of $105,000 and $84,615 from Hurley/Binson's Medical Equipment at June 30, 2006 and 2005, respectively. HPMS and HHS purchase courier services from Hurley/Binson's Medical Equipment, Inc. in the amount of $240,000 annually.

Note 16 - Prior Period Adjustment

The accompanying financial statements of Hurley Medical Center for the year ended June 30, 2005 have been restated to comply with financial reporting under GASB for the Medical Center's investment in HHS. Under the provisions of GASB, HHS is required to be reported as a component unit of the Medical Center. As the parent company, the Medical Center should not have been reporting the equity investment in HHS as an asset of the Medical Center. The effect of the restatement of the Medical Center for 2005 was to decrease the beginning of year fund net assets by $7,165,475 and to decrease other assets and the net assets at June 30, 2005 by $6,836,176, with a related increase in the increase in net assets of $329,299 for the year ended June 30, 2005 as compared to amounts previously reported.

Note 17 - Capital Assets and Depreciation

Property, plant, and equipment and the related accumulated depreciation at June 30, 2006 are summarized by categories as follows:

	Capital Assets				Accumulated Depreciation			
Hurley Medical Center	June 30, 2005	Additions	Transfers	June 30, 2006	June 30, 2005	Depreciation Expense	Transfers	June 30, 2006
Land	$ 3,695,472	$ 120,544	$ -	$3,816,016	$ -	$ -	$ -	$ -
Land improvements	3,880,819	217,687	(2,061)	4,096,445	3,573,127	168,605	(2,061)	3,739,671
Buildings:								
Medical center building	106,373,518	1,721,003	(383,435)	107,711,086	85,304,935	3,071,494	(318,784)	88,057,645
Parking structure	2,531,728	716,091	-	3,247,819	2,250,112	48,109	-	2,298,221
Nurses' residence	1,725,380	-	-	1,725,380	1,364,137	38,358	-	1,402,495
Interns' apartment	303,482	-	-	303,482	279,003	4,037	-	283,040
Prospect street apartments	1,253,073	-	-	1,253,073	1,164,255	23,491	-	1,187,746
Power plant	2,350,495	1,162,496	(60,970)	3,452,021	1,816,603	145,065	(43,451)	1,918,217
Rental property	350,497	-	-	350,497	339,256	3,260	-	342,516
Health and fitness center	4,565,319	-	-	4,565,319	3,450,875	204,956	-	3,655,831
Park Plaza	1,258,501	-	-	1,258,501	968,726	44,041	-	1,012,767
Physicians' office building	336,566	-	-	336,566	234,811	15,263	-	250,074
Northpointe Clinic	1,778,012	4,856	-	1,782,868	460,613	51,456	-	512,069
Davison Clinic	1,901,857	3,400	-	1,905,257	434,025	55,936	-	489,961
Longway Eastside Campus bldg.	4,091,057	64,212	-	4,155,269	660,930	147,815	-	808,745
Total buildings	128,819,485	3,672,058	(444,405)	132,047,138	98,728,281	3,853,281	(362,235)	102,219,327
Machinery and equipment	97,132,489	9,204,999	(15,122,976)	91,214,512	75,299,393	6,311,193	(14,135,196)	67,475,390
Automotive equipment	296,397	32,770	(71,303)	257,864	237,707	14,308	(54,644)	197,371
Construction in progress	3,285,831	12,803,535	(13,127,511)	2,961,855	-	-	-	-
Total Hurley Medical Center	$237,110,493	$26,051,593	$(28,768,256)	$234,393,830	$177,838,508	$10,347,387	$(14,554,136)	$173,631,759
Hurley Health Services								
Leasehold improvements	$ 1,286,015	$ 22,639	$ (96,645)	$ 1,212,009	$ 308,198	$ 66,544	$ (27,385)	$ 347,357
Equipment and furnishings	2,075,730	55,813	(77,284)	2,054,259	1,496,515	144,557	(70,992)	1,570,080
Total Hurley Health Services	$ 3,361,745	$ 78,452	$ (173,929)	$ 3,266,268	$ 1,804,713	$ 211,101	$ (98,377)	$ 1,917,437

Note 17 - Capital Assets and Depreciation (Continued)

Property, plant, and equipment and the related accumulated depreciation at June 30, 2005 are summarized by categories as follows:

	Capital Assets				Accumulated Depreciation			
Hurley Medical Center	June 30, 2004	Additions	Transfers	June 30, 2005	June 30, 2004	Depreciation Expense	Transfers	June 30, 2005
Land	$ 3,667,589	$ 27,883	$ -	$3,695,472	$ -	$ -	$ -	$ -
Land improvements	3,852,985	28,231	(397)	3,880,819	3,487,163	86,361	(397)	3,573,127
Buildings:								
Medical center building	105,347,482	1,093,142	(67,106)	106,373,518	82,107,190	3,255,089	(57,344)	85,304,935
Parking structure	2,527,293	4,435	-	2,531,728	2,159,781	90,331	-	2,250,112
Nurses' residence	1,520,413	204,967	-	1,725,380	1,336,027	28,110	-	1,364,137
Interns' apartment	303,482	-	-	303,482	274,966	4,037	-	279,003
Prospect street apartments	1,253,073	-	-	1,253,073	1,140,075	24,180	-	1,164,255
Power plant	2,350,495	-	-	2,350,495	1,698,797	117,806	-	1,816,603
Rental property	350,497	-	-	350,497	335,381	3,875	-	339,256
Health and fitness center	4,565,319	-	-	4,565,319	3,242,989	207,886	-	3,450,875
Park Plaza	1,258,501	-	-	1,258,501	906,511	62,215	-	968,726
Physicians' office building	329,816	6,750	-	336,566	218,388	16,423	-	234,811
Northpointe Clinic	1,778,012	-	-	1,778,012	406,569	54,044	-	460,613
Davison Clinic	1,901,857	-	-	1,901,857	378,202	55,823	-	434,025
Longway Eastside Campus bldg.	4,027,518	63,539	-	4,091,057	517,459	143,471	-	660,930
Total buildings	127,513,758	1,372,833	(67,106)	128,819,485	94,722,335	4,063,290	(57,344)	98,728,281
Machinery and equipment	94,105,463	6,342,523	(3,315,497)	97,132,489	72,422,087	6,055,875	(3,178,569)	75,299,393
Automotive equipment	363,471	14,085	(81,159)	296,397	289,518	21,519	(73,330)	237,707
Construction in progress	1,627,192	9,444,195	(7,785,556)	3,285,831	-	-	-	-
Total Hurley Medical Center	$231,130,458	$17,229,750	$(11,249,715)	$237,110,493	$170,921,103	$10,227,045	$(3,309,640)	$177,838,508
Hurley Health Services								
Leasehold improvements	$ 1,285,240	$ 775	$ -	$ 1,286,015	$ 269,636	$ 38,562	$ -	$ 308,198
Equipment and furnishings	2,087,237	70,326	(81,833)	2,075,730	1,432,000	140,251	(75,736)	1,496,515
Total Hurley Health Services	$ 3,372,477	$ 71,101	$ (81,833)	$ 3,361,745	$ 1,701,636	$ 178,813	$ (75,736)	$ 1,804,713

Required Supplemental Information

Hurley Medical Center Division
City of Flint Employees Retirement System
Required Supplemental Information
Analysis of Funding Progress

Plan Year End	Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability Attained Age (AAL)(b)	(Unfunded) Over Funded AAL (a – b)	Funded Ratio (a/b)	Covered Payroll (c)	(UAAL) as % of Payroll (b – a)(c)
6-30-97	12-31-95	$238,204,021	$220,503,557	$17,700,464	108.0	$87,333,791	0.0
6-30-98	12-31-96	257,531,709	242,476,930	15,054,779	106.2	83,112,658	0.0
6-30-99	12-31-97	301,060,938	259,985,429	41,075,509	115.8	87,651,874	0.0
6-30-00	12-31-98	322,497,186	281,563,941	40,933,239	112.7	96,417,303	0.0
6-30-01	12-31-99	340,608,779	306,134,487	34,474,292	111.3	107,246,608	0.0
6-30-02	12-31-00	354,306,658	328,489,881	25,816,777	107.9	105,102,019	0.0
6-30-03	12-31-01	367,058,240	333,802,804	33,255,436	110.0	103,411,340	0.0
6-30-04	12-31-02	357,836,531	399,476,922	(41,640,391)	89.6	103,802,756	40.1
6-30-05	12-31-02	357,836,531	399,476,922	(41,640,391)	89.6	103,802,756	40.1
6-30-06	6-30-04	338,311,878	430,746,829	(92,434,951)	78.5	110,096,227	84.0

Additional Information

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To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

We have audited the financial statements of the business-type activities of Hurley Medical Center (a component unit of the City of Flint, Michigan) for the year ended June 30, 2006 and 2005. Our audit was made for the purpose of expressing an opinion on the basic financial statements taken as a whole. The accompanying additional information is presented for analysis purposes and is not a required part of the financial statements. The consolidating schedules have been subjected to the tests and other auditing procedures applied in the audits of the financial statements mentioned above and, in our opinion, are fairly stated in all respects material in relation to the financial statements taken as a whole, except said presentation includes certain departures from accounting principles under the Governmental Accounting Standards Board statements, as described below, but is intended to be a presentation comparable to hospital industry practices for not-for-profit health care providers. The primary changes are in the presentation of financial statements on a consolidated basis for the Medical Center and its component unit, reflecting the equity investment in the component unit as an asset of the Medical Center, reflecting the provision for uncollectible accounts as an operating expense rather than as a reduction in net patient service revenues, and reflecting interest expense as an operating expense in the consolidating statement of revenues and expenses.

Plante & Moran, PLLC

September 22, 2006

Assets	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Current assets:			
Cash and cash equivalents	$ 20,112,540	$ 2,553,368	$ -
Patient accounts receivable, net	58,975,912	315,601	-
Other receivables	7,659,076	785,302	(619,830)
Inventories	3,290,619	53,214	-
Prepaid expenses and other	2,348,436	1,289,148	-
Assets limited as to use	3,510,414	334,158	-
Total current assets	95,896,997	5,330,791	(619,830)
Assets limited as to use:			
By the board	59,754,231	334,158	-
Under bond indenture agreement - Held by trustee	12,457,972	-	-
Restricted	390,113	-	-
Total assets limited as to use	72,602,316	334,158	-
Less assets limited as to use that are required for current liabilities	(3,510,414)	(334,158)	-
Total noncurrent assets whose use is limited	69,091,902	-	-
Other assets:			
Deferred reimbursement and defeasance loss	894,053	-	-
Bond issuance costs, net	630,927	-	-
Investment in joint ventures	6,296,628	1,153,809	-
Investment in Hurley Heath Services	6,520,563	-	(6,520,563)
Other	-	150,000	-
Total other assets	14,342,171	1,303,809	(6,520,563)
Property, plant, and equipment, net	60,762,071	1,348,831	-
Total assets	**$ 240,093,141**	**$ 7,983,431**	**$ (7,140,393)**

Additional Schedules are not GAAP basis under GASB, but are for comparative purposes to hospital industry practices for not-for-profit health care providers.

Total June 30, 2006	Total June 30, 2005
$ 22,665,908	$ 23,917,419
59,291,513	69,518,712
7,824,548	5,039,777
3,343,833	3,585,718
3,637,584	3,588,682
3,844,572	4,646,665
100,607,958	110,296,973
60,088,389	50,238,640
12,457,972	12,363,497
390,113	369,340
72,936,474	62,971,477
(3,844,572)	(4,646,665)
69,091,902	58,324,812
894,053	1,022,042
630,927	700,810
7,450,437	6,945,636
-	-
150,000	59,430
9,125,417	8,727,918
62,110,902	60,829,017
$ 240,936,179	**$ 238,178,720**

(continued)

		Hurley Medical Center		Hurley Health Services		Eliminations for Consolidation
Liabilities and Fund Net Assets						
Current liabilities:						
Accounts payable and taxes withheld	$	15,430,844	$	206,119	$	(619,830)
Current portion of long-term debt and lease obligations		3,797,912		-		-
Accrued expenses		32,582,586		1,256,749		-
Total current liabilities		51,811,342		1,462,868		(619,830)
Accrued expenses		40,952,281		-		-
Lease obligations, net of current portion		1,379,634		-		-
Long-term debt, net of current portion		64,277,937		-		-
Total liabilities		158,421,194		1,462,868		(619,830)
Fund net assets:						
Invested in capital assets, net of related debt		6,954,524		1,348,831		(1,348,831)
Unrestricted		71,194,386		5,171,732		(5,171,732)
Restricted		3,523,037		-		-
Total fund net assets		81,671,947		6,520,563		(6,520,563)
Total liabilities and fund net assets	**$**	**240,093,141**	**$**	**7,983,431**	**$**	**(7,140,393)**

Additional Schedules are not GAAP basis under GASB, but are for comparative purposes to hospital industry practices for not-for-profit health care providers.

Total June 30, 2006	Total June 30, 2005
$ 15,017,133	$ 14,409,600
3,797,912	3,630,789
33,839,335	22,017,039
52,654,380	40,057,428
40,952,281	33,945,547
1,379,634	2,979,013
64,277,937	66,258,673
159,264,232	143,240,661
6,954,524	1,837,183
71,194,386	89,971,216
3,523,037	3,129,660
81,671,947	94,938,059
$ 240,936,179	**$ 238,178,720**

	Hurley Medical Center	Hurley Health Services	Eliminations for Consolidation
Operating revenues:			
Net patient service revenues	$ 294,327,354	$ 4,335,585	$ -
Other operating revenues	27,644,161	18,004,860	(17,385,835)
Total operating revenues	321,971,515	22,340,445	(17,385,835)
Operating expenses:			
Salaries and wages	126,524,408	14,002,158	-
Professional services	32,298,913	84,854	(13,268,126)
Payroll taxes and fringes	50,196,050	2,712,468	-
Supplies	37,738,735	-	-
Purchased services and other	48,027,466	5,374,785	(820,228)
Depreciation and amortization expense	10,347,386	223,991	-
Interest expense	4,503,057	-	-
Provision for uncollectible accounts	25,783,919	-	-
Total operating expenses	335,419,934	22,398,256	(14,088,354)
Net operating loss	(13,448,419)	(57,811)	(3,297,481)
Nonoperating revenues (expenses):			
Investment income and unrestricted donations	121,581	58,367	-
Management fees to PHO and joint venture income (expense)	(247,034)	(316,169)	3,297,481
Total nonoperating revenues (expenses)	(125,453)	(257,802)	3,297,481
Excess (deficiency) of revenues over expenses before other activity	(13,573,872)	(315,613)	-
Other:			
Decrease in investment in Hurley Health Services	(315,613)	-	315,613
Assets released from restrictions for the purchase of capital assets	229,996	-	-
Total other	(85,617)	-	315,613
Excess (deficiency) of revenues over expenses before restricted fund activity and transfer of funds	(13,659,489)	(315,613)	315,613
Restricted fund activity and transfer of funds:			
Restricted gifts and bequests	1,798,029	-	-
Income and investments	81,684	-	-
Transfer of fund to general fund:			
Capital asset additions	(229,996)	-	-
Other operating revenue (expenses)	(1,256,340)	-	-
Increase (decrease) in fund net assets	(13,266,112)	(315,613)	315,613
Fund net assets - Beginning of year	94,938,059	6,836,176	(6,836,176)
Fund net assets - End of year	**$ 81,671,947**	**$ 6,520,563**	**$ (6,520,563)**

Additional Schedules are not GAAP basis under GASB, but are for comparative purposes to hospital industry practices for not-for-profit health care providers.

Consolidating Statement of Revenues, Expenses, and Changes in Fund Net Assets
Year Ended June 30, 2006

Year Ended June 30, 2006	Year Ended June 30, 2005
$ 298,662,939	$ 316,914,837
28,263,186	24,679,240
326,926,125	341,594,077
140,526,566	139,953,980
19,115,641	18,249,165
52,908,518	49,310,193
37,738,735	35,501,721
52,582,023	55,168,931
10,571,377	10,483,568
4,503,057	2,957,176
25,783,919	34,970,385
343,729,836	346,595,119
(16,803,711)	(5,001,042)
179,948	2,448,058
2,734,278	2,677,943
2,914,226	5,126,001
(13,889,485)	124,959
-	-
229,996	317,329
229,996	317,329
(13,659,489)	442,288
1,798,029	1,647,519
81,684	45,205
(229,996)	(317,329)
(1,256,340)	(1,352,260)
(13,266,112)	465,423
94,938,059	94,472,636
$ 81,671,947	**$ 94,938,059**

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September 22, 2006

To the Board of Hospital Managers
Hurley Medical Center
Flint, Michigan

Dear Board of Hospital Managers:

In planning and performing our audit of the financial statements of Hurley Medical Center for the year ended June 30, 2006, we considered the Medical Center's internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted a certain matter involving the internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect the Medical Center's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Interim Contractual Allowance Calculation

Monthly contractual computations are arguably the most important step to insure accurate monthly financial statements are accurate and represent the true results of operations of the Medical Center. The current contractual allowance system computes the monthly contractual allowances on a global basis determined on such factors as volumes and budgeted amounts. In addition, the balance sheet accounts related to the contractual allowances are only reviewed and adjusted at year end. Also, the general account structure for the processing of third-party transactions was very condensed. Each third-party receivable (retention) account contained the current year processed transactions and prior year settlements. The global estimate for the monthly contractual allowance was recorded to one third-party account (receivable/contractual). This condensed accounting process makes it very difficult to review and analyze the accounts receivable allowances and related revenue provisions on an interim basis. Also, it requires a substantial amount of time at year end to reconcile and adjust the balances to the proper amounts.

The majority of clearing related to third-party transactions are posted to a single balance sheet general ledger account and income statement general ledger account. This makes it very difficult to review and analysis the accounts receivable allowances and related revenue provisions on a regular basis and requires a substantial amount of time at year end to reconcile and adjust the balances to the proper amounts. Settlements due from third-party payors are also recorded in the same accounts as the accounts receivable allowances which further complicates the reconciliation process.

During 2006, the Medical Center engaged Plante & Moran, PLLC to establish a model to calculate a payor specific contractual allowance for the current year activity. The new model was completed at December 31, 2005 and April 30, 2006 by the reimbursement staff and compared the results to the global method. Also, a new account structure was developed to separate into different accounts the current year transactions and prior year settlements.

At June 30, 2006, the Medical Center had a substantial amount of monies due it by various third-party payors including, but not limited to, Medicare, Medicaid, and Health Plus. Following is a summary of the significant receivables:

- The Medical Center has approximately $3,600,000 recorded as a receivable related to Medicare cost reports for years ended between June 30, 1995 through June 30, 2001. These cost reports have been final settled by Medicare but the Medical Center has appealed many issues related to these final settlements. Per discussions with Medical Center employees as well as the outside consultant working on this appeals, it appears a significant portion of these issues have been resolved and the Medical Center expects revised final settlement by December 31, 2005.
- The Medical Center has approximately $1,500,000 due from the Medicaid program related to the years ended between June 30, 1999 and June 30, 2004. These years have been initially settled by the State of Michigan and the majority of the receivables relate to Medicaid claims that cleared subsequent to the date of the initial settlement.
- The Medical Center has a net receivable of approximately $2,300,000 related to Health Plus and Health Plus Partners related to the years ended June 30, 1997 through June 30, 2005. Based on conversations with Medical Center personnel, it does not appear a system is in place to "final settle" these years.

We estimate when all interim payments related to the year ended June 30, 2006 are received and all related claims are cleared, the Medical Center will have a receivable of approximately $10,000,000 from the significant third-party payors.

Based on our observations, we recommend the following:

- Review the monthly process for posting third-party transactions to the general ledger and make the necessary adjustments to ensure that the proper accounts are utilized on a monthly basis.
- Segregate settlements related to prior years into unique general ledger accounts by payor at a minimum.
- Implement the new account structure to segregate the prior year settlements.
- Implement the payor specific model tested during 2006 on a monthly basis.

- On at least a quarterly basis, review the balance sheet amounts related to accounts receivable allowances to determine the reasonableness of the accounts based on open accounts receivable.
- Review all open third-party settlements and contact the appropriate third-party payor regarding the status of the settlements. The Medical Center should make a concerted effort to close out a significant portion of these prior year settlements before June 30, 2007.
- On a quarterly basis at a minimum, compute estimated third-party settlements for the current year for payors on an interim payment system. If the computation indicates significant amounts due the Medical Center, the third-party payor should be contacted regarding an adjustment in the rates.

Observations, Comments, and Recommendations:

During the audit, we also observed other matters that, while not considered reportable conditions, we feel should be communicated to you. We have also summarized some additional areas for board consideration. Beside each comment is the audit year the comment was first issued. Any comments issued in a prior year that has been resolved by management has not been re-issued on this report.

We have already discussed many of these comments and suggestions with the various personnel of the Medical Center, and we will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Impact of New GASB Regarding Retiree Health Care Liabilities (June 30, 2005)

The Governmental Accounting Standards Board issued a new pronouncement, GASB Statement No. 45, *Accounting and Financial Reporting by Employees for Post-employment Benefits Other Than Pensions,* that will require governmental entities to reflect the estimated liability for retiree health care costs (that is not funded through a pension trust) on the balance sheet of the governmental unit. The liability is required to be actuarially calculated and to cover the estimated cost of the benefit over a period approximating the employees' years of service. Currently, the Medical Center pays for a portion or all of retiree health care premiums for various retiree groups. The pronouncement is effective for the Medical Center for fiscal years beginning after December 15, 2006. While the implementation is a few years away we want to make the management and the board aware of this accounting standard so that preparations can be made to implement the standard.

Management has engaged Gabriel Roeder Smith to analyze the GASB 43 and GASB 45 impact. The Medical Center is working with the actuary to be in compliance for fiscal year end 2008.

Pension Plan Funding (June 30, 2006)

The estimated amount of the employer portion of the pension plan contribution has been recorded for fiscal year 2006 and after as an expense on the books of the Medical Center; however, the actual funds have not yet been transferred to either the Flint Employee Retirement System (FERS) or the Michigan Municipal Employee Retirement System (MERS). Management is working with FERS and MERS to resolve the discrepancy relating to the transfer of previously accumulated plan assets for the Medical Center's employee groups that have been approved to transfer from the FERS to the MERS plan. In the interim, however, the amount of cash owed by the Medical Center to the pension plans continues to increase. It is therefore recommended that the matter of how to fund each pension plan be resolved as quickly as possible.

Additionally, to determine the amount of employer pension expense recorded for the employees in the MERS plan, management is using a rate that was estimated by the actuary more than a year ago. This rate being used may differ from what will be required to be remitted to MERS to fund the employer portion of the plan. In order to have a more accurate estimate of the pension expense, management should work with MERS and the actuary to determine the actual contribution rate that will be required under the MERS plan.

Reimbursement Manager Job Duties (June 30, 2006)

The reimbursement manager of the Medical Center has duties outside of those duties normally assumed by a hospital reimbursement manager. In addition to the reimbursement accounting duties, the reimbursement manager of the Medical Center also is responsible for other finance areas such as review of the bank reconciliations and investment and debt accounting. We recommend that, due to the time and complexity involved in the reimbursement area, another finance staff member assume additional duties currently being performed by the reimbursement manager, leaving the reimbursement manager free to concentrate on the reimbursement duties.

This report is intended solely for the information and use of the board of hospital managers, management, and others within the Medical Center and is not intended to be and should not be used by anyone other than these specified parties.

Thank you for the opportunity to be of service to Hurley Medical Center. Should you wish to discuss any of the items included in this report, we would be happy to do so.

Very truly yours,

Plante & Moran, PLLC

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